Marijuana legalization grows closer with Senate tax proposal

Want to legalize marijuana federally? Propose sensible taxes on the drug.

That’s the tactic of a new bill from two Oregon Democrats: House Ways and Means Committee member Earl Blumenauer and ranking Senate Finance Committee member Ron Wyden. It takes on tough questions: What should a marijuana tax measure? Should it tax medical marijuana? The Marijuana Revenue and Regulation Act (MRRA) provides thoughtful answers.

What to tax?

The 64-page bill, S. 776, and House companions H.R. 1823 and 1841, starts out problematically, taxing marijuana by price for a five-year transition period, but ends up brilliantly, with sophisticated weight-based taxes for the long run. A companion bill repeals the useful current tax on advertising.

Price

For its first five years, the MRRA taxes marijuana by percentage of producer price, with rates ratcheting up from 10 percent to 25 percent.

Taxing by price means that when the pre-tax price goes down, taxes do, too. So do after-tax prices. Low taxes and cheap weed are not on everyone’s wish list. After legalization, pre-tax prices are bound to wither. Fully legal marijuana won’t sell for hundreds or even dozens of dollars per ounce, pre-tax. Is the MRRA’s final 25 percent rate high enough? Will five years be too long? No one knows. As a tax design architect — yes, that’s a thing — I’ll leave the numbers to the economists.

But price taxes create another problem. In case of “vertical integration” like a farm-to-market operation, the bill shies away from taxing the actual price the
consumer pays, so it imagines an artificial — and probably arbitrary — “constructive [producer] price ... determined by the Secretary” of the Treasury. This is the amount one person, who is both retail clerk and farmer, supposedly pays his farmer self as a wholesale price. Shenanigans galore! Colorado has this kind of unworkable producer price tax on the books but, finding it doesn’t work, has quietly given up. Colorado taxes producers by weight instead.

**Weight**

Eventually, after five years, the MRRA taxes “concentrates” — processed marijuana used in liquid form or put into “edibles,” as when baked into cookies — by the number of grams they contain of marijuana’s primary intoxicant, tetrahydrocannabinol (THC). Chemistry reveals the amount of THC in the processed product. So far, so good.

As for unprocessed plant material — “naturally grown and unadulterated marijuana flower,” the bill taxes by the ounce.

That’s less theoretically beautiful, but it makes perfect sense. Measuring THC in flower involves guesswork, sampling error and gamesmanship. Ever wonder why no jurisdiction taxes cigarettes by nicotine content? Nicotine, like THC in the marijuana flower, is too tricky to measure accurately enough for the government work of taxation. Sure, taxing by weight incentivizes powerful marijuana — stuff that’s rich in THC. But unless we’re willing to take the seller’s word for THC content, the MRRA’s Colorado-style weight tax on flowers is the best we can hope for.

How much per gram or per ounce will the MRRA charge in taxes eventually? It has a formula designed to keep the amount of tax owed the same after the five-year transition ends. It aims to convert the price tax burden — the amount of tax owed — to a weight tax burden.

Technically, it takes the per-ounce “prevailing sales price” of flower during
the fifth and final price-tax year, multiplies it by that year’s 25 percent tax rate, and makes that the per-ounce tax on flower. For THC measured in concentrates, the per-ounce rate is 10 times the flower rate. That’s an equivalent for flower that is 10 percent THC by weight. Commendably, the bill adjusts those tax rates annually for marijuana price inflation.

A final word about federal design: Federal taxes need to be high enough to prevent the kind of interstate tax arbitrage that causes criminals to buy low-taxed cigarettes at retail in Virginia to resell illegally in New York. Marijuana is enormously more valuable by weight and volume than tobacco. A high federal tax, high enough to dominate the field, would address that problem. A credit for state taxes paid could leave states whole.

Advertising

We can tax marijuana sellers directly, by price or weight. Or they can be taxed indirectly, by denying deductions.

The marijuana industry says it wants to be treated like any other legal industry. But the public thinks intoxicant industries are special, and will make them pay special taxes. Taxing marijuana advertising — indirectly, by making it non-tax-deductible — seems like a prudent place to start.

The MRRA is part of a package that includes the Small Business Tax Equity Act, which would allow legal marijuana sellers to deduct marketing and advertising expenses for the first time. Today, Tax Code Section 280E prevents that. It says sellers can deduct only cost of goods sold — what they pay to grow or buy marijuana.

To be sure, another part of the package, the Responsibly Addressing the Marijuana Policy Gap Act, limits marijuana advertising somewhat. But only somewhat. The First Amendment’s commercial free speech doctrine protects advertising for anything that’s legal. But the Constitution doesn’t require tax deductions for lobbying or for other forms of speech, like
advertising.

Repeal of 280E is a big revenue loser, if you believe the industry. And marijuana consumer lobby NORML points out that advertising is a red flag to opponents of legalization, who worry that children will be attracted to the drug. NORML says 280E is overbroad, but keeping non-deductibility for just advertising and marketing expenses has a lot to recommend it. Non-tax advertising restrictions and tax non-deductibility can be complementary.

NORML also worries, despite the “small business” title, that a deduction for ads subsidizes Big Business, which can afford ads. Small businesses can use free word-of-mouth marketing.

But the media loves advertising deductions for their customers, so denying them is tough, politically. (If President Trump figures out that the media he scorns loves advertising deductions, watch out!)

Medical marijuana

The MRRA seems to get medical marijuana right.

A tax exemption for medical marijuana would be a gaping hole. In some states, qualifying as a medical marijuana patient is a cinch. Figuring out who has “severe pain” is hard for doctors, and harder for tax authorities. Under Prohibition, medicinal alcohol was legal, but once Prohibition was repealed, making it tax-exempt was a non-starter.

The MRRA won’t tax marijuana that is “approved by the Food and Drug Administration for sale for therapeutic purposes and is marketed and sold solely for such purpose.” That’s the best medical marijuana language I’ve seen. If all goes well, fake patients can’t beat the tax — or resell tax-free product to others.

The MRRA is just as tight on home growers. Copying the federal liquor tax, it taxes even the smallest home operation, preventing leakage.
Summing up

Marijuana legalization may seem remote, but the thinking on a potential federal marijuana tax is getting serious. The Marijuana Revenue and Regulation Act takes on several tough issues. It doesn’t arrive at final answers, but with a ground-breaking THC tax and a just-right medical marijuana exemption, it takes steps in the right direction.

Pat Oglesby is director and founder of the Center for New Revenue. He previously served as chief tax counsel at the U.S. Senate Finance Committee and as international tax counsel at the Joint Congressional Committee on Taxation. Find him on Twitter at @OglesbyPat

The views of contributors are their own and are not the views of The Hill.